IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 138 of 1985

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

COMMISSIONER OF INCOME-TAX

Versus

VIMAL ELECTRIC CO.

Appearance:

MR MIHIR JOSHI for MR MANISH R BHATT for Petitioner

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE D.A.MEHTA

Date of decision: 15/06/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE A.R.DAVE)

At the instance of the revenue the following question of law has been referred to this Court for its opinion under the provisions of sec. 256(2) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') by the Income Tax Appellate Tribunal, Ahmedabad Bench 'A'.

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in coming to the conclusion that for the purpose of calculating relief under sec. 80HH of the Income-tax Act, 1961, the gross profit has to be determined after including interest paid by the assessee to its partners and disallowable under sec. 40(b) of the Act?"

2. We have heard learned advocate Shri Mihir Joshi appearing for the revenue. Though served, nobody has appeared for the respondent assessee.

3. The facts which have given rise to the present reference, in a nutshell, are as under :

4. The assessee, which is a partnership firm, had established a new industrial undertaking in a backward area and had therefore claimed deduction under the provisions of sec. 80HH of the Act. The Assessing Officer, while taking into account the amount of profits for the purpose of determination of deduction u/s 80HH of the Act, excluded the amount of interest added under sec. 40(b) of the Act. Though no reason was stated in the order by the Assessing Officer for doing so, possibly he excluded the said amount of interest from the profits because no special mode has been prescribed for determining profits under the provisions of sec. 80HH of the Act. Being aggrieved by the said view taken by the Assessing Officer, the assessee filed an appeal before the CIT (Appeals), but the appeal was dismissed. In the circumstances, the assessee filed an appeal before the Tribunal and the Tribunal allowed the appeal by holding that the amount of interest, which was paid by the assessee firm to its partners, was required to be added in the profits of the assessee for calculating deduction at the rate of 20% under the provisions of sec. 80HH of the Act.

5. The question which this Court has to decide is whether for the purpose of ascertaining profits of the assessee for the purpose of determining the amount of deduction u/s 80HH of the Act, interest given to the

partners, which is disallowed under the provisions of sec. 40(b) of the Act, should be added in the profits.

6. We have heard learned advocate Shri Mihir Joshi appearing for the revenue. It has been submitted by him that the Tribunal was in error while taking the view referred to hereinabove for the reason that the firm had incurred expenditure by paying interest to its partners and therefore the said amount of interest, which was in fact an expenditure of the firm, should not have been added in the profits of the firm. It has been submitted by him that as no special method for determining profits has been prescribed under sec. 80HH of the Act, profits should be determined as per the normal accounting practice and therefore the amount of interest paid to the partners, which is an expenditure of the firm, ought to have been deducted from the gross receipts fo the firm.

7. We have heard learned advocate Shri Joshi at length and have also perused the facts of the case and other relevant provisions of the Act. We are not in agreement with the submissions made by learned advocate Shri Joshi appearing for the revenue for the reasons stated hereinbelow and we are of the view that the Tribunal was justified in taking the view which it has taken.

8. For the purpose of determining the profits derived from the industrial undertaking and for arriving at the amount of deduction which the assessee is entitled to under sec. 80HH of the Act, one has to look at the provisions of sec. 80AB of the Act. As per the provisions of sec. 80AB, subject to certain exceptions, where any deduction is required to be made or allowed under any of the sections included in Chapter VI-A of the Act, the amount of income is to be computed in accordance with the provisions of the Act before making any deduction under the said Chapter. Thus, for the purpose of ascertaining the amount of deduction, which is required to be allowed under the provisions of sec. 80HH, the profits are to be ascertained as per the provisions of the Act.

9. Section 28 of the Act gives details with regard to the income which are chargeable to income tax under the head "profits and gains of business or profession" and sec. 29 prescribes the mode in which the income, which has been referred to in sec. 28, is to be computed. As per the provisions of sec. 29 of the Act, the income is to be computed in accordance with the provisions contained in the sections referred to therein.

For the relevant assessment year, income referred to in sec. 28 was to be computed in accordance with the provisions contained in sections 30 to 43 of the Act. Thus, according to the said section, for the purpose of computing income referred to in sec. 28 of the Act, provisions of sec. 40(b) are to be considered. According to the provisions of sec. 40(b) of the Act, when a firm is an assessee, any payment of salary, bonus, commission, remuneration or interest paid to any partner of the firm is to be added in the profits of the firm. Thus, when any amount of interest is paid to the partners of the firm, the amount of interest paid to the partners is to be added in the profits of the assessee firm. The said provision has been incorporated in the Act so as to see that the income of the firm is not artificially reduced or siphoned away by the firm by paying interest, salary, bonus etc. to the partners of the firm. When, by virtue of any of the terms of the partnership agreement, any amount is given to a partner as salary or wages or interest, normally the partner gets the said amount as an allocation of the profits prior to the general division of the profits among the partners. Possiby on the above analogy, according to the provisions of sec. 40(b) of the Act, an amount of interest, which is paid to the partners, is to be added in the profits of the firm for the purpose of computation of its profits.

10. As stated hereinabove, the income of the assessee firm is to be determined as per the provisions of the Act, and u/s 40(b) of the Act the amount of interest, which is paid by the assessee firm to its partners, is to be added in the income of the assessee. Moreover, looking to the provisions of sec. 80AB of the Act, profits and gains of an assesee firm are not commercial profits but they are only such profits as are computed in the manner prescribed under the Act. When the Act prescribes a particular manner in which the profits of the assessee are to be determined, the revenue cannot be permitted to prescribe a separate mode of ascertaining profits when the assessee is entitled to some deduction from the profits. Therefore, in the instant case, the Tribunal has rightly interpreted and given effect to the sections referred to hereinabove while allowing deduction to the assessee firm under the provisions of sec. 80HH of the Act and the Assessing Officer was definitely in error when he adopted a mode of ascertaining profits which has not been prescribed under the Act.

11. Looking to the legal provisions stated hereinabove, we are of the view that the Tribunal was absolutely right in law in coming to the conclusion that

for the purpose of calculating profits under sec. 80HH of the Act, gross profits had to be determined after including interest paid by the assessee firm to its partners, which was disallowable under sec. 40(b) of the Act. Thus, we answer the question in the affirmative, i.e. in favour of the assessee and against the revenue.

The reference stands disposed of accordingly with no order as to costs.

(A.R. Dave, J.)

(D.A. Mehta, J.)

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